

## Message Text

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ACTION EB-11

INFO OCT-01 ISO-00 ABF-01 L-03 EA-11 SS-20 INR-10 RSC-01

DRC-01 /059 W

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R 250910Z OCT 73

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 720

INFO AMEMBASSY TOKYO

AMEMBASSY TAIPEI

AMCONSUL HONG KONG

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STADIS////////////////////////////////////

REF A STATE 190671 B TOKYO 12564 C STATE 196460

D TOKYO 12969 E STATE 201371 F TOKYO 13170

SUMMARY: GAO AUDITOR TEAM CONDUCTED INQUIRY OCTOBER 10-19 INTO IMPACT OF U.S. KOREA TEXTILE AGREEMENTS ON CONSUMER PRICES, INDUSTRY CONDITIONS (U.S. AND KOREAN), AND EMBASSY OPERATIONS. MAIN CONCLUSIONS WERE: (1) PRICE EFFECTS UNCERTAIN; (1) U.S. INDUSTRY HAS BENEFITTED WHILE KOREAN INDUSTRY ONLY MINIMALLY HURT; (3) EMBASSY OPERATIONS ONLY SLIGHTLY AFFECTED. TEAM WILL RECOMMEND THAT CURRENT EXPORTER QUOTA SYSTEM BE REPLACED BY SYSTEM IN WHICH QUOTAS ARE ALLOCATED TO IMPORTERS. END SUMMARY

1. GAO AUDITORS COMPETELLO AND GLYNN VISITED SEOUL OCTOBER 10-19 TO CONDUCT SUBJECT REVIEW. SCOPE OF INQUIRY WAS VIRTUALLY SAME AS IN TOKYO (REFS (B), (D), AND (F) EXCEPT THAT AUDITORS APPEARED TO ASSUME THAT VIEWS OF GOJ-JAPANESE INDUSTRY AND ROKG-KOREAN INDUSTRY WOULD BE VERY SIMILAR, AND THUS IN KOREA INTERVIEWS OUTSIDE EMBASSY WERE LIMITED AND RATHER CURSORY. MUCH OF TEAM'S TIME IN SEOUL WAS DEVOTED TO PREPARATION OF JAPAN AND KOREA REPORTS. (COPIES OF LATTER LIMITED OFFICIAL USE

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BEING POUCHED EA/K, ASIA/EA, EB/FTD AND EMBASSY

TOKYO. JAPAN REPORT NOT AVAILABLE.) TEAM INTERVIEWED OFFICIALS OF QUOTA CONTROL DIVISION -MINISTRY OF COMMERCE AND INDUSTRY (MCI), U.S. IMPORTERS REPRESENTING, INTER ALIA, MONTGOMERY WARD, REPRESENTATIVE OF DAE WOO INDUSTRIES -LARGEST KOREAN SHIRT EXPORTER AND KOREAN GARMENT EXPORTERS ASSOCIATION OFFICIAL. IN ADDITION TO KENNEDY/LEE LETTER OF OCTOBER 16, 1971 (REF (E), EMBASSY MADE AVAILABLE TO TEAM TEXTILE INDUSTRY REPORTS, COPIES OF TEXTILE AGREEMENTS, AND POST-AGREEMENT TELEGRAPHIC TRAFFIC CONCERNED WITH EMBASSY'S "MONITORING" FUNCTION, PARTICULARLY IN CONNECTION WITH TQ CLASSIFICATION AND OVERSHIPMENT PROBLEMS.

2. FOLLOWING IS SUMMARY OF QUESTIONS ASKED BY GAO TEAM AND ANSWERS THEY GOT IN SEOUL.

A. KOREAN ATTITUDES TOWARD TEXTILE AGREEMENTS -- AUDITORS GOT IMPRESSION FROM ALL INTERVIEWEES THAT BOTH KOREAN GOVERNMENT AND INDUSTRY WOULD PREFER ABOLITION OF EXPORT RESTRAINT AGREEMENTS, ALTHOUGH EMBOFF POINTED OUT THAT COMBINATION OF TIME AND SURPRISING SUCCESS IN FINDING ALTERNATIVE EXPORT MARKETS (PARTICULARLY IN JAPAN) HAS SERVED TO BLUNT MUCH OF ORIGINAL KOREAN RESENTMENT. RECENT TRADE DATA SHOW MARKED SHIFT AWAY FROM EARLIER HEAVY DEPENDENCE ON U.S. MARKET, ALONG WITH FAILURE TO FILL QUOTAS IN SEVERAL MAN-MADE TQ CATEGORIES IN SECOND AGREEMENT YEAR. TEAM CONCLUDED THAT ELIMINATION OF WOOL AND MAN-MADE AGREEMENTS WOULD PROBABLY LEAD TO GREATER CONCENTRATION IN PROFITABLE AND CURRENTLY FASHIONABLE LINES RATHER THAN INCREASE IN AGGREGATE EXPORT LEVELS TO U.S. IN CASE OF COTTON, ON OTHER HAND, TEAM CONCLUDED AFTER TALKING WITH U.S. IMPORTER, THAT ELIMINATION OF AGREEMENT WOULD LEAD TO SUBSTANTIAL INCREASE IN EXPORTS. RATIONALE WAS THAT SMALL SIZE OF COTTON QUOTA AND ITS FRAGMENTATION AMONG LARGE NUMBER OF KOREAN PRODUCERS CAUSE LARGE U.S. BUYERS OF COTTON GOODS TO IGNORE KOREA.

B. CONCESSIONS GRANTED TO SECURE TEXTILE AGREEMENT -- LIMITED OFFICIAL USE

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AS INDICATED ABOVE, EMBASSY PROVIDED AUDITORS WITH COPY OF OCTOBER 16, 1971 KENNEDY/LEE LETTER OUTLINING "INCREMENTAL" ECONOMIC ASSISTANCE TO KOREA AMOUNTING TO DOLS 375 MILLION OVER FIVE-YEAR PERIOD OF MAN-MADE AND WOOL TEXTILE AGREEMENT. INCREMENTAL ASSISTANCE THEN ENVISIONED INCLUDED DOLS 175 MILLION IN ESTIMATED ADDITIONAL PL 480, DOLS 100 MILLION SAVINGS VIA REDUCED CURRENCY USE PAYMENT (CUP) REQUIREMENTS UNDER

PL 480, AND DOLS 100 MILLION IN DEVELOPMENT LOANS. EMBOFF POINTED OUT THAT RECENT SUSPENSION OF PA ISSUANCE FOR PL 480 COMMODITIES HAS REDUCED VALUE OF THIS PACKAGE BY AN AS YET UNDETERMINED AMOUNT. WHEN AUDITORS ASKED HOW VALUE OF PACKAGE WAS DECIDED UPON, EMBOFF (WHO ASSISTED IN NEGOTIATIONS) EXPLAINED THAT KENNEDY TEAM AND MCI HAD CALCULATED THAT VALUE OF FOREGONE KOREAN TEXTILE EXPORTS TO U.S. OVER FIVE-YEAR PERIOD AS RESULT OF TEXTILE AGREEMENT WOULD BE BETWEEN DOLS 600 AND DOLS 700 MILLION. USING THEN APPLICABLE RULE OF THUMB OF 50 PERCENT KOREAN VALUE-ADDED IN TEXTILE EXPORTS, NET TRADE LOSS OF DOLS 325 MILLION WAS PROJECTED. TO ASSURE AGREEMENT INCREMENTAL ASSISTANCE PACKAGE WAS PUT TOGETHER HAVING GREATER ESTIMATED VALUE THAN CALCULATED NET TRADE LOSS. OF THE ROUGHLY DOLS 250 MILLION IN PL 480 COMMODITIES KOREA HAS RECEIVED IN CY'S 1972 AND 1973, EMBOFF ESTIMATED (AT AUDITORS'S REQUEST) THAT PERHAPS DOLS 49 MILLION COULD BE REGARDED AS TEXTILE AGREEMENT RELATED. IN ADDITION, KOREA HAS RECEIVED TO DATE DOLS 55.5 MILLION IN DEVELOPMENT LOANS AS RESULT OF KENNEDY LETTER.

C. EMBASSY INVOLVEMENT IN TEXTILE AGREEMENTS -- EMBOFF EXPLAINED TO AUDITORS THAT EMBASSY AS SUCH WAS NOT INVOLVED IN NEGOTIATION OF WOOL AND MAN-MADE AGREEMENT. FROM TIME TO TIME, HOWEVER, INDIVIDUAL OFFICERS PROVIDED ASSISTANCE TO KENNEDY PARTY IN FOLLOWING AREAS: ADMINISTRATIVE SUPPORT, PREPARATION OF DATA AND ASSESSMENT OF LIKELY KOREAN REACTION TO VARIOUS PROPOSALS. BASED ON EMBASSY ESTIMATES, TEAM CALCULATED ANNUAL COST OF EMBASSY'S POST-AGREEMENT MONITORING ACTIVITIES AT DOLS 2,000.

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ACTION EB-11

INFO OCT-01 ISO-00 ABF-01 L-03 EA-11 SS-20 INR-10 RSC-01

DRC-01 /059 W

----- 081848

R 250910Z OCT 73

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 721

INFO AMEMBASSY TOKYO

AMEMBASSY TAIPEI

AMCONSUL HONG KONG

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D. COST TO U.S. CONSUMERS -- AUDITORS FOUND NO  
CONSENSUS AMONG INTERVIEWEES AS TO IMPACT OF TEXTILE  
AGREEMENTS ON RETAIL CLOTHING PRICES IN U.S. KEY  
QUESTIONS ARE: (1) DO KOREAN COMPANIES BUY AND SELL  
QUOTA? (2) ARE U.S. IMPORTERS CHARGED HIGHER PRICES  
THAN OTHER IMPORTERS?; (3) IF PRICES TO U.S. IMPORTERS  
ARE HIGHER, DO IMPORTERS PASS HIGHER PRICES THROUGH  
TO CONSUMERS? TEAM HEARD CONTRADICTORY ANSWERS TO ALL  
THREE QUESTIONS, AND THUS CONCLUDED THAT IN ELEVEN-  
MONTH PERIOD THROUGH AUGUST 31, 1973, TEXTILE AGREE-  
MENTS LED TO HIGHER COSTS FOR U.S. CONSUMERS SOMEWHERE  
IN RANGE FROM ZERO TO DOLS 12.5 MILLION. (LATTER  
FIGURE DERIVED FROM OFF-THE-CUFF ESTIMATE BY U.S.  
IMPORTER THAT U.S. BUYERS PAY DOLS 2 TO DOLS 2.50  
MORE PER DOZEN FOR SHIRTS THAN EUROPEAN BUYERS.) IN  
COURSE OF PRICE INQUIRY AUDITORS UNCOVERED WHAT THEY  
FELT WERE CERTAIN UNDESIRABLE EFFECTS OF TEXTILE  
AGREEMENTS: SINCE QUOTA IS STATED IN SQUARE YARDS,  
THERE IS TENDENCY FOR KOREANS TO ENCOURAGE COMPANIES TO  
MAXIMIZE DOLLAR EARNINGS PER SQUARE YARD. AS A  
RESULT, EXPORTS OF INEXPENSIVE MERCHANDISE AND  
CHILDREN'S WERE ALLEGEDLY HAVE BEEN SHARPLY REDUCED.  
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E. CARTELIZATION -- ALTHOUGH KOREAN POLICIES FAVOR  
LARGER AND MORE EFFICIENT FIRMS, FOR EXAMPLE IN  
QUOTA ALLOCATION, TEAM FOUND NO EVIDENCE OF CARTELIZA-  
TION OF KOREAN TEXTILE INDUSTRY AS RESULT OF TEXTILE  
AGREEMENTS. ONE TEXTILE MANUFACTURER TOLD TEAM  
KOREAN FIRMS WOULD BE UNABLE TO TRUST DOMESTIC OTHER TO  
LIVE UP TO PRICE-FIXING ARRANGEMENTS. EMBOFF POINTED  
OUT THAT MINIMUM EXPORT PRICE SYSTEM WHICH GOVERNMENT

TRIED TO IMPOSE IN EARLY 1972 WAS ABANDONED AFTER FEW MONTHS AS UNWORKABLE.

F. KOREAN TEXTILE IMPORT RESTRICTIONS -- EMBOFF EXPLAINED THAT ROKG POLICIES OF PROHIBITING EXPORTS OF LUXURY GOODS AND PROTECTION OF DOMESTIC INDUSTRY EFFECTIVELY ELIMINATE IMPORTS OF TEXTILES EXCEPT THOSE WHICH ARE TO BE FURTHER PROCESSED AND RE-EXPORTED.

G. RATIONALE FOR AGREEMENTS AND ALTERNATIVE ARRANGEMENTS -- WHEN QUESTIONED BY AUDITORS RE USG RATIONALE FOR TEXTILE AGREEMENTS, EMBOFF INDICATED HE WAS UNAWARE OF DETAILS OF STATE OF U.S. TEXTILE INDUSTRY AT TIME AGREEMENTS WERE NEGOTIATED, AND EXPRESSED VIEW THAT POLITICAL AS WELL AS ECONOMIC MOTIVATIONS MAY HAVE PLAYED ROLE. WHEN AUDITORS ASKED ABOUT ALTERNATIVE METHODS OF ACCOMPLISHING OBJECTIVES OF TEXTILE AGREEMENTS, EMBOFF EXPRESSED IGNORANCE OF ANY MAGIC FORMULA FOR ATTAINMENT OF TWO GOALS PREDICATED BY GAO TEAM: PROTECTION OF DOMESTIC TEXTILE INDUSTRY WHILE MAINTAINING LOW TEXTILE PRICES FOR DOMESTIC CONSUMERS. HE EXPRESSED VIEW THAT IMPORTER QUOTA SYSTEM, WHICH AUDITORS SEEMED TO FAVOR (SEE PARA I BELOW), WOULD BE VERY DIFFICULT TO ADMINISTER IN U.S. AND WOULD RUN COUNTER TO PREVAILING BELIEF THAT GOVERNMENT INTERFERENCE IN BUSINESS ACTIVITY SHOULD BE MINIMIZED. FINALLY, IN DISCUSSING "COSTS" OF TEXTILE AGREEMENT, EMBOFF NOTED THAT USG PRESUMABLY HAS FINITE AMOUNT OF LEVERAGE IN KOREA, SOME OF WHICH WAS CONSUMED IN SECURING TEXTILE AGREEMENTS.

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H. CONCLUSIONS -- AUDITORS CONCLUDED THAT THE PRICE EFFECTS AND OTHER COSTS OF AGREEMENT ARE UNCERTAIN AND DIFFICULT TO ASSESS. IN TERMS OF AVAILABILITY OF GOODS, LOW INCOME CONSUMERS AND PURCHASERS OF CHILDREN'S WEAR MAY BE ADVERSELY AFFECTED BY AGREEMENT'S TENDENCY TO DISCOURAGE EXPORTS OF THESE GOODS. THE AGREEMENT BENEFITS THE U.S. DOMESTIC INDUSTRY WHILE NOT SERIOUSLY HARMING KOREAN INDUSTRY IN THE LONG RUN. IN FACT, IN VIEW OF KOREA'S CONTINUING STRONG TEXTILE EXPORT PERFORMANCE, AUDITORS SUGGEST THAT AID PACKAGE OUTLINED IN KENNEDY LETTER MAY NOT HAVE BEEN NECESSARY.

I. RECOMMENDATIONS -- TO STIMULATE COMPETITION, AUDITORS RECOMMEND SHIFT TO QUOTAS FOR U.S. IMPORTERS, COUPLED WITH PRICE CONTROLS TO PREVENT IMPORTERS FROM

RAISING PRICES. ALTERNATIVELY IMPORT LICENSES COULD  
BE AUCTIONED, WITH USG OBTAINING PROFITS. THEY WOULD  
ALSO REQUIRE THAT CERTAIN PERCENTAGE OF QUOTA BE USED  
FOR IMPORTS OF LOW COST, LOW QUALITY GOODS. WHILE  
AUDITORS RECOMMEND BROADER CATEGORIES FOR IMPORTER  
QUOTAS, THEY ALSO ENVISAGE EXPORTER COUNTRY SUB-  
QUOTAS WITHIN WORLD WIDE IMPORT QUOTAS AND RECOMMEND  
THAT IF A COUNTRY FAILS TO UTILIZE ALL OF ITS QUOTA  
OVER A NUMBER OF YEARS, THIS UNUSED QUOTA SHOULD BE  
SHIFTED TO LDC EXPORTING COUNTRIES SUCH AS KOREA.  
CONSIDERATION OF HIGHER TARIFFS IN LIEU OF IMPORT  
QUOTAS IS ALSO URGED AT END OF REPORT.  
HABIB

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